
A CRITICAL STUDY CONCERNING THE PREPARATION OF THE STATEMENT OF CASH FLOWS THROUGH THE INDIRECT METHOD IN ROMANIA

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Abstract:

Although not bound by law, by option, small and medium entities from Romania can prepare the statement for the modifications within their equity and / or the statement of cash flows. When companies select this option, any decision made by the consumer of accounting information is better founded, from the perspective of information sources that it uses, rather than the opposite, because the users of accounting information about a company are almost always interested by the way in which the company generates and uses cash and cash equivalents. In this paper we present the particularities implied in Romania by the preparation of the statement of cash flows using the indirect method.

Keywords: the statement of cash flows, Romania, cash, cash equivalents, the indirect method

1. Introduction

The entire array of synthesis documents which are being prepared when the financial exercise is coming to an end are composing elements of the annual financial statements. Their objective is to supply information on the financial position, performance and cash flows of an entity (van Greuning, 2007).

The complete set of financial statements consists of, according to the International Financial Reporting Standards (Standardele Internaționale de Raportare Financiară: IFRS: norme oficiale emise la 1 ianuarie 2009, 2009):

- The status of the financial position at the end of the exercise (balance sheet);
- A statement of the global result for the exercise that passed (operating profit / loss account);
- A statement of the mutations within the equity of the company during that exercise;
- A statement of the cash flows of that respective exercise,

- Notes, consisting of a brief presentation of significant accounting policies and other explanatory information,
- A statement of the financial position at the beginning of the first comparative exercise, when the company applies a retroactive accounting policy or tackles anew elements from previous financial statements, or when it reclassifies various elements from its financial statements.

According to the general IASB framework (International Accounting Standards Board), the IAS 1 standard – A General Presentation of Financial Statements regulates the structure of the balance sheet, of the operating profit / loss account and the status of the modifications within the company's equity, whereas IAS 7 – The statement of Cash flows regulates the status of the statement of cash flows.

The provisions of these documents, valid and abided in our country at present (OMFP 3055, 2009) establish the following limits for enterprises when preparing their financial statements as size criteria:

- Total assets: 3.650.000 Euro,
- Sales: 7.300.000 Euro,
- Average number of employees during the financial exercise: 50.

Enterprises which at the end of the financial exercise surpass the limits of two of the three criteria, prepare annual financial statements which include:

- Balance sheet,
- Operating profit / loss account,
- The statement of equity modifications,
- The statement of cash flows,
- Explanatory notes to the annual financial statements.

Entities which at the balance sheet deadline do not surpass the limits of two criteria of size mentioned above only have to prepare simplified annual financial statements which include:

- Short balance sheet,
- Operating profit / loss account as annex to the annual simplified financial statements.

Although not bound by law, by option, entities from Romania mentioned in the latter category can also prepare the statement for the modifications within their equity and / or the statement of cash flows. When companies select this option, any decision made by the consumer of accounting information is better founded, from the perspective of information sources that it uses, rather than the opposite, because the users of accounting information about a company are almost always interested by the way in which the company generates and uses cash and cash equivalents. According to Broome (2004) "a comparison of operating cash flow with net income is necessary to evaluate current cash flows from income-producing activities". Feleagă (1996) affirms that the statement of cash flows "makes it possible for the investor to spread access to information in order to appreciate the ability of the enterprise to pay dividends. Its interest lies more within monetary flows rather than accounting benefits or derivate indicators". We cannot state, though, that making a decision on the basis of

accounting information, while considering the cash flows generated by the economic entity, will spare the investor from the full extent of the manifestation of unforeseen effects, but it certainly helps to reduce their magnitude. In conclusion, in our opinion, all Romanian enterprises whose financial statements address a vast array of potential users should certainly prepare complete annual financial statements, which must include all the five components mentioned above, whether the law requires it or not.

2. Cash and cash equivalents

Through cash, one may comprehend, from the perspective of cash flows, the totality of available cash at a given moment (both in bank accounts and in cash) and short term deposits, meaning the cash which an entity may access immediately.

Available cash which the company has available at a given moment and through which it operates payments in relations with other economic entities represents the available cash and foreign cash from its cash desk. The cash book records the daily evidence of all cash operations, registered on the basis of official documents; within the registry one marks incoming cash or entries, as well as payments, and the daily balance, at the end of the day.

Cash operations have a series of advantages, of which we mention quickness and safety during the transaction (from the perspective of suppliers), but also disadvantages such as using a large amount of cash and the unsafe nature of the physical transfer.

Cash equivalents consist of short term financial investments, which are extremely liquid, easily convertible in known amounts of cash and which are subject of an insignificant value exchange risk.

Cash equivalents can be used to fulfill short term company engagements, as investments or for a different purpose. A short term placement is considered as cash equivalent only when it has a short term maturity, usually three months since the acquisition was made.

Cash flows designate the ensemble of incomings and outgoings of cash and cash equivalents in and out of the company. The difference between positive and negative flows represents the *net cash flow*.

Cash flows exclude the movements between elements which constitute cash or cash equivalents, because these components are part of the cash management and only lead to a structural modification of the treasury and not of its volume. Cash management involves placing cash surplus in cash equivalents.

3. Grouping cash flow according to their generative actions

Within the preparation of the cash flow statement, there is a paramount importance given to the classification of flows, using as a demarcation criterion the cash generating activity or cash equivalent. In using the mentioned criterion, we have the following cash flow classes:

- Operating,
- Investments,
- Financing.

In using each class, there are both encashment cash flows as well as payment cash flows. Net cash flows can be calculated for each of the three classes (operating, investments, financing), by determining the difference between encashment and payments. The formula used as such is:

$$\begin{array}{rcl} \text{Net operating/} & & \text{Operating} \\ \text{financing/} & & \text{encashment/} \\ \text{investments} & = & \text{financing /} \\ \text{cash flow} & & \text{investments} \end{array} \quad - \quad \begin{array}{l} \text{Payments concerning} \\ \text{operating/ financing/} \\ \text{investments activities} \end{array}$$

As we will see in the following pages, the calculus variant which was presented in advance is not the only one to determine cash flows from the operating activity.

Operating activities include, according to IAS 7 (<http://www.iasplus.com/en/standards/standard7>), the main activities which produce income for entities, as well as other activities which are not investment activities or financing activities. Cash flows which come from operating activities constitute an important part of the statement of cash flows, because it reveals the success or failure registered by these activities in generating sufficient flows in order to reimbursement of credits, the payment of dividends and the realization of new investments without the entity being forced to attract external financing sources.

As an example we mention the following receipts which are part of the operating cash flows:

- Income from the selling of goods and services.
- Income from charges, fees, commissions and other revenues,
- Income of an insurance company for damages and premiums, etc.

The following payments are part of the category of operating cash flows, and their presentation does not have an exhaustive character:

- Payments made by an insurance company for premiums and damages;
- Payments made by suppliers of goods and services;
- Payments of salaries and contributions linked to salaries;
- Payment of taxes, except the case in which they are identified as being specific to investment or financing activities, etc.

We believe that an easy way to identify cash flows generated by operating activities is by exclusion, meaning by the cancelation of investment and financing activities, fewer and easier to identify from this point of view, from the total of activities developed by an enterprise. Activities which are left after the fulfillment of this operation are operating operations, and the revenues and payments bound to them will represent cash flows generated by operating activities.

Investment activities (IAS 7, <http://www.iasplus.com/en/standards/standard7>) consist of buying and ceasing tangible assets on a long term, as well as other investments, which are not included in cash equivalents.

From the category of cash flows generated by investment activities, we have, as example:

- Income from the sale of tangible, intangible or financial assets,
- Income from reimbursement of loans contracted by third parties, other than loans contracted by a financial institution, etc.

Examples of payments from the cash flow category from investment activities include, without this enumeration having an administrative character:

- Payments for the acquisition of tangible, intangible and financial assets;
- Payments for loans granted by third parties, other than those given by a financial institution, etc.

Financing activities (IAS 7, <http://www.iasplus.com/en/standards/standard7>) are activities which have as effect modifications within the dimension and composition of equity and debts of the entity.

From the category of encashment cash flows generated by financing activities we have, for example:

- Income from the issuing of stocks or other equity instruments;
- Income from the issuing of title claims, loans, uninsured debt, bonds, mortgages and other short and long term loans, etc.

Payment examples from the category of cash flows from financing activities include, without the enumeration being exhaustive:

- Payments made by owners to purchase or redeem stocks of the entity;
- Payments made to diminish existing obligations linked to financial leasing operations;
- Payments made to reimburse contracted loans, etc.

There are transactions which can generate, at the same time, cash flows which fit into more than one category of activities. For example, the payment made for a loan which includes a certain amount of interest supported for it can be broken down into the following activities: interest *can be* included in cash flows generated by Operating activities, and the main part of the credit (the rate per se), will be included within the cash flows generated by the financial activities. On the other hand, encashment linked to a loan given by another entity than those which are recognized as financial institutions, which also includes interest for them, can be broken down into: the interest, which *can be* included in cash flows generated by operating activities, and the principal (the rate per se), will be included into cash flows generated by investment activities.

Interest paid or received can be treated as mentioned, because the international financial reporting standards foresee special treatment, for both cash flows which represent interest as well as for flows which represent dividends. Thus, paid interest rates and received interest rates and dividends can be included in the

category of operating cash flows or, in an alternative manner, paid interest rates can be included within the category of financial cash flows, and received interest and dividends can be included in the category of investment cash flows. Paid dividends can be included in the category of financial cash flows or, alternatively, can be considered in the category of operating cash flows.

4. Elaboration of the statement of cash flows through the indirect method in Romania – a critical analysis

In order to prepare and present the cash flows, in time, two methods became accepted, and they are now mentioned in IAS 7 (Standardele Internaționale de Raportare Financiară: IFRS: norme oficiale emise la 1 ianuarie 2009, 2009):

- The direct method,
- The indirect method.

The direct method involves the identification and inclusion of gross encashments and payments of cash and cash equivalents within the cash flow statement, made by an enterprise.

The indirect method represents an alternative of the direct method used to *establish the value of net cash flows as a result of the operating activity*. One must take into account the fact that by practicing accrual accounting, one registers income and expenses when they are engaged and not when they are paid, and in the calculus of the final result non-monetary elements are taken into account, which do not call for entries and exits of cash from the treasury, which makes for an increase of the difference between the size of the generated output and the size of treasury cash (Dragotă et al., 2003). The indirect method adjusts the net profit (or net loss) with elements of income and expense associated with investment or financing activities (because they are not linked with the operating activity), with the effects of transactions which are not monetary in essence (because they do not generate cash entries or exits), and with the reductions or increases of payment and encashment engagements, in cash or cash equivalents from operating activities (in order to eliminate the effects of accrual accounting on the treasury). According to Wang (2010) the indirect method “makes the concept of reconciliation between the accrual- and cash-basis more thorough and complete”

The starting point is the net result obtained by the company and the goal is to determine the net flow from operating activities. In order to reach this objective one eliminates, from the final result, all the effects of the operations which affect the result, but do not generate cash flows associated to the operating activity. Thus, one eliminates, from the result:

1. The influences of operations which do not have a monetary character such as, for example, depreciation expenses, income from the cancelling of constituted provisions as well as other income and expenses which are part of the same category, meaning elements whose registration does not involve the

performing of payments or encashments. Expenses eliminated from the result are taken into account with the plus sign, and revenues are cancelled, with the minus sign, because in the calculus of the result, expenses had the minus sign, and revenues had the plus sign. Because one eliminates their effects on the result, they will be considered with signs contrary to their initial signs in its determination.

2. Elements of income and expenses which concern investment or financing activities, regardless if their registration has or has not involved an entry of cash or payment of cash, because they refer to other activities than the operating one. And these revenues and expenses, as those found, will be considered with opposite signs than those they had at first in order to determine the result, meaning that expenses will be considered with plus, and revenues with minus.
3. The influences on the treasury of the variations of elements composing the working capital required, afferent to the operating activities. In this case, we use the following reasoning: in the case of assets, their value increase during the year has a negative influence on the treasury, whilst a reduction of value, a positive influence; in the case of liabilities, the reasoning is quite opposite. In order to understand the variation of the exploitation working capital required, one begins from the following calculus relation:

$$\text{Need for Working Capital from operating (NWCE)} = \text{Operating assets} - \text{Operating liabilities}$$

Within the operating assets we include inventories, trade receivables and other similar elements, other claims afferent to operating activities and prepaid expenses afferent to the operating activity.

Trade payables and other similar elements, fiscal and social debts as well as the rest of operating debts and deferred revenues afferent to operating activities are included within operating liabilities.

Considering the calculus methodology described before, the net cash flow from operating activities is determined as follows:

$$\text{Net operating flow} = \text{NR} - \text{Uncashed operating revenues} + \text{Unpaid operating expenses} - \text{Financing or investment revenues} + \text{Financing or investment expenses} - \Delta\text{NWCE}$$

Where

$$\Delta\text{NWCE} = \text{NWCE} (1) - \text{NWCE} (0)$$

The period in-between purchase, production and sale claims for the creation of inventories, and the time gap between real and financial flows gives birth to payables and receivables, as follows:

- The time gap between purchasing and payment implies the apparition of payables;
- The time gap between sales and encashments attracts the formation of receivables.

Thus the increase of value for operating assets implies an increase of the value of operating inventories, receivables, or prepaid expenses made for the operating activity. Analyzing their registration into accounting, we usually meet the following situations:

- In order to record the increase of value for inventories purchased with immediate payment, the accounting formula is as follows:

$$\begin{array}{l} \textit{Accounts of purchased} \\ \textit{inventories} \end{array} = \begin{array}{l} \textit{Cash or cash equivalents} \\ \textit{accounts} \end{array} \quad \textit{Amount}$$

One can notice, in this particular situation, that an increase of the value of purchased inventories determines an increase of operating assets and of the working capital required in operating activities. This positive variation of the working capital required affects in a negative and direct way the cash flow from operating activities by the apparition of a payment.

- In order to register the increase of the purchased inventories value, bought on commercial credit, the accounting formula is as follows:

$$\begin{array}{l} \textit{Accounts of purchased} \\ \textit{inventories} \end{array} = \begin{array}{l} \textit{Trade payables accounts} \\ \end{array} \quad \textit{Amount}$$

One can notice that, in this situation, we have an increase of the value of purchased inventories, which determines an increase of operating assets at the same time with an increase, with the same sum of operating liabilities and, as a consequence, the working capital required remains constant.

- In order to register the increase of the value of inventories obtained from the own production of the entity, the accounting formula is the following:

$$\begin{array}{l} \textit{Accounts of inventories} \\ \textit{obtained from own production} \end{array} = \begin{array}{l} \textit{Accounts of revenues} \\ \textit{from production} \end{array} \quad \textit{Amount}$$

One can notice that in this situation, an increase of the value of own production inventories determines an increase of revenues from production and of the working capital from operating activities. In this case even the result increases with the value of the variation of revenues from the inventories production, without these revenues to be illustrated in encashments. We observe that we find ourselves in a situation similar to the one described in the previous point 1. In this case, the positive variance of the working capital required from operating activities affects the operating treasury in a negative way (in an indirect manner) being decreased in order to determine it, because the revenue from

the stock variation which is registered determines an increase of the result without this increase to correspond to an encashment.

- In order to register the increase of value for operating trade receivables, results from the registering of engaged income (which will be cashed in the future) the accounting formula is as follows:

$$\begin{array}{l} \textit{Operating trade receivables} \\ \textit{accounts} \end{array} = \begin{array}{l} \textit{Engaged revenues} \\ \textit{accounts} \end{array} \quad \textit{Amount}$$

One can observe that in this situation a value of increase for operating trade receivables determines an increase of engaged revenues and the working capital required from operating activities. In this case, the result increases with the value of the variation of engaged revenues. This value does not generate encashments. We observe that we find ourselves in a situation similar to the one described before. In this case also, the positive variation of the working capital required affects in a negative fashion the operating activity cash flow (in an indirect manner) being decreased in order to determine it, because the engaged revenue registered determined an increase of the result without that increase to correspond to encashments.

- In order to register the increase of the value of prepaid expenses made for the operating activity the accounting formula is the following:

$$\begin{array}{l} \textit{Prepaid expenses accounts} \\ \end{array} = \begin{array}{l} \textit{Cash or cash equivalents} \\ \textit{accounts} \end{array} \quad \textit{Amount}$$

We can observe that, in this situation, an increase of the value of prepaid expenses for the operating activity determines an increase of operating assets and the operating working capital required. This positive variation of the working capital required from operating activities affects in a negative and direct manner the operating activity cash flow by the apparition of a payment.

The decrease of the value of operating assets implies a decrease of inventories value, operating trade receivables, or prepaid expenses made for the operating activity. Analyzing the registering into accounting of these situations, we usually meet the following cases:

- In order to register the decrease of value for purchased inventories (with immediate payment or commercial credit), the accounting formula is the following:

$$\begin{array}{l} \textit{Expenses with purchased} \\ \textit{inventories} \end{array} = \begin{array}{l} \textit{Accounts of purchased} \\ \textit{inventories} \end{array} \quad \textit{Amount}$$

One can notice that, in this situation, we have a decrease of the value of inventories purchased which determines an increase of purchased inventories expenses

and a reduction of the operating working capital required. In this case, the result also decreases with the value of the variation of purchased inventories expenses, without those expenses to correspond to payments made. We observe here that we find ourselves in a similar situation to the one described in point 1. In this case, the negative variation of the working capital required from operating activities affects the operating cash flow in a positive manner (in an indirect manner), and is added for its determination, because registered purchased inventories expenses have determined a decrease of the result, without that decrease to correspond to a payment.

- In order to register the decrease of the value of inventories obtained from own production, the accounting formula is the following:

$$\begin{array}{l} \text{Accounts of revenue from} \\ \text{production} \end{array} = \begin{array}{l} \text{Accounts of inventories} \\ \text{obtained from own} \\ \text{production} \end{array} \quad \text{Amount}$$

One can observe that in this situation we have a decrease of inventories obtained from own production, which determines a decrease of revenues from production and a decrease of the operating working capital required. In this case we also have a decrease of the result, decrease equal with the value of the variation of the revenues from stocked production, without this decrease to correspond to payments. We observe here that we are in a similar situation to the one presented at point 1. In this case the negative variation of the operating working capital required affects in a positive manner the operating activity cash flow (in an indirect manner), being added for its determination, because the diminishing of revenues from registered stock production has determined a decrease of the result, without this decrease to correspond to payments.

- In order to register the decrease of the value of trade receivables from operating activities, the accounting formula is the following:

$$\begin{array}{l} \text{Cash or cash equivalents} \\ \text{accounts} \end{array} = \begin{array}{l} \text{Operating trade} \\ \text{receivables accounts} \end{array} \quad \text{Amount}$$

One can observe that in this situation, a reduction of the value of operating trade receivables determines a reduction of operating assets and of the operating working capital required. This negative variation of the operating working capital required affects in a positive and direct manner the operating cash flow through the apparition of an encashment.

- In order to register the reduction of the value of prepaid expenses made for the exploitation activity the accounting formula is the following:

$$\begin{array}{l} \text{Period expenses accounts} \end{array} = \begin{array}{l} \text{Accounts for prepaid} \\ \text{expenses} \end{array} \quad \text{Amount}$$

One can observe that in this situation we have a decrease of the value of prepaid expenses, which determines an increase of the period expenses and a reduction of the operating working capital required. In this case, the result also decreases with the variation of the period expenses, without those expenses corresponding to payments. We notice

that we find ourselves in a similar situation to that described at point 1. In this case, the negative variation of the operating working capital required affects in a positive manner the operating cash flow (indirectly) being added to determine it, because the registered period expenses have determined a decrease of the result, without that decrease corresponding to a payment.

The increase of the liabilities` operating value implies an increase of the value of trade payables or of deferred revenues realized for the operating activity. By analyzing their registration into accounting, we usually meet the following situations:

- In order to register the increase of trade payables through the acquisition of inventories through commercial credit the accounting formula is:

$$\begin{array}{lcl} \text{Accounts of purchased} & = & \text{Accounts of trade} \\ \text{inventories} & & \text{payables} \end{array} \quad \text{Amount}$$

One can observe, that in this situation, we have an increase of the value of operating trade payables, which determines an increase of the operating liabilities, at the same time with an increase of the amount of the operating assets, and, as a consequence, the operating working capital required remains constant. The operating cash flow is not affected.

- In order to register the increase of trade payables through the acquisition of services through commercial credit the accounting formula is the following:

$$\begin{array}{lcl} \text{Period expenses accounts} & = & \text{Accounts of trade} \\ & & \text{payables} \end{array} \quad \text{Amount}$$

One can observe that in this situation an increase of the value of trade payables determines an increase of the period expenses and a reduction of the operating working capital required. In this case, the result decreases with the value of the variation of expenses registered in the period, without those expenses corresponding to payments. We observe here that we find ourselves in a situation similar to the one described at point 1. In this case, the negative variation of the operating working capital required affects the operating cash flow in a positive and indirect manner, being added to determine it, because the expenses of the registered period have determined a decrease of the result, without that decrease to correspond to payments.

- In order to increase the value of deferred revenues realized for the operating activity, the accounting formula is the following:

$$\begin{array}{lcl} \text{Cash accounts or cash} & = & \text{Deferred revenues} \\ \text{equivalents} & & \text{accounts} \end{array} \quad \text{Amount}$$

We can observe that in this situation the increase of the value of deferred revenues realized for the operating activity determines an increase of operating liabilities and a decrease of the operating working capital required. This negative variation of the operating working capital affects in a positive and direct manner the operating cash flow through the apparition of an encashment.

The decrease of value for Operating liabilities implies a decrease of the value of Operating debts or advance revenues realized for the Operating activity. By analyzing their registration into accounting, we usually have the following statements:

- In order to register the reduction of the value of Operating debts the accounting formula is the following:

$$\text{Accounts of Operating debts} = \text{Cash accounts or cash Amount equivalents}$$

One can observe that in this statement a reduction of the value of Operating debts determines a reduction of the Operating liabilities and an increase of the Operating working capital required. This positive variation of the Operating working capital required affects in a negative and direct manner the Operating of the cash flow by the apparition of a payment.

- In order to register the reduction of the value of advance income for the Operating activity, the accounting formula is as follows:

$$\text{Accounts of advance revenues} = \text{Period revenues Amounts accounts}$$

One can observe that in this situation, the decrease of the value of deferred revenues determines an increase of the period revenues and an increase of the operating working capital needed. In this case, the result also increases with the value of the variation of the period revenues, without those revenues to correspond to encashments. We observe here that we find ourselves in a situation similar to the one described at point 1. In this case, the positive variance of the operating working capital required affects in a negative and indirect manner the operating cash flow, being eliminated in order to determine it, because the period revenues have determined an increase of the result, without them corresponding to an encashment.

From the analysis of the situations presented above, we can trace the following *conclusions*:

- All the operations made by an enterprise which determine an increase of the need for operating working capital affect in a negative manner the cash flows afferent to the operating activity, with the value of that respective increase;
- All the operations made by an enterprise which determine a decrease of the need for Operating working capital, affect, in a positive manner, the cash flows afferent to the Operating activity, with the value of that decrease.

In synthesis, our main demonstration is proven correct, namely the fact that a positive variation of the operating working capital required for the period for which the financial statements are prepared determine a decrease of the operating cash flows which is equal to the value of that variation. A negative variation of the operating working capital required generates, of course, opposite effects, namely an increase of cash flows, equal to the value of that variation.

According to the Romanian law (OMFP 3055, 2009), operating cash flows can be presented according to the indirect method by using the following presentation format:

Gross profit (before the registration of expenses with taxes and profit and of interest expenses –our note)

Amortization expenses (+)

Expenses with provisions and adjustments for the depreciation or value loss (+)

Revenues from reevaluation of provisions and depreciation adjustments or value loss (-)

Financial expenses (+)

Financial revenues (-)

Expenses concerning ceased assets (+)

Revenues from asset sale (-)

Variation of trade receivables accounts and other operating receivables* (at the negative variation +, at the positive variation -)

Variation of trade payables accounts and other operating debts* (at the negative variation -, at the positive variation +)

Variation of inventories revenues accounts* (at the negative variation +, at the positive variation -)

Paid Interest Rates** (-)

Paid Profit Tax** (-)

= Net Operating cash flow

* the variation is determined as a difference between values of the respective elements at the end of the period and values of those elements at the beginning of the period

**although paid interest rates (if one opts for their inclusion within operating activities) and the paid profit tax are part of the variation of other operating liabilities, the format chooses to present them in a separate manner. As we mentioned before, an entity may classify paid interest, as well as received interest and dividends as operating, financing, or investment cash flows. Paid dividends can be included as financing or operating cash flows. This classification must be used in a consequent manner from one period to another.

5. Conclusions

In the format of the cash flow statement submitted by the national accounting laws and presented before, it is stated that the gross result is the starting point. Because at the beginning of this paper we mentioned that the preparation of the cash flows must begin from the net result, we mention that the calculus algorithm submitted by national law is the same as the one we describe only if the meaning of the expression “gross result” is understood by the legislator as the result before the registration of profit expenses and interest expenses (GR’). In this case, between the result before the registration of profit taxes and interest expenses and the net result (NR) we have the following relation:

$$GR' = NR + \text{Profit tax expenses} + \text{Interest expenses}$$

Considering this manner to calculate the “gross result” which, as mentioned before, does not actually describe the gross result but rather the earnings before the registration of the profit tax and interest expenses, the calculus methodology which we

described, and the one submitted by the national legislator are similar concerning the value of the operating cash flow (if the accounting registrations are correct).

Actually, when the description of the indirect method is made, IAS 7 presents the same manner of calculating the cash flow from the operating activity as the national law, except (and this is to be noted) what we mentioned, meaning the usage, instead of the concept of gross result of that of earnings before the registration of profit tax expenses and interest expenses.

Although IAS 7 recommends the usage of the direct method to prepare the cash flow statement in order to better satisfy the informational need of information users, many enterprises choose to apply the indirect method, due to its simplicity. On this issue we support the idea that "past period direct method cash flow data predict future operating cash flow better than indirect method cash flow data", stated by Krishnan and Largay III (2000). Supporting the same idea Bradbury (2011) affirms "that the direct cash flow reporting format, relative to the indirect method, leads to better prediction of future firm performance and has a stronger association with share prices".

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